

Message Text

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C O N F I D E N T I A L LIMA 6379

E.O. 11652: GDS

TAGS: EGEN, EFIN, PINT, PE

SUBJECT: PERU'S ECONOMIC CRISIS - SOME POLICY PARAMETERS

REF: A. LIMA 6223; B. LIMA 6227

1. SUMMARY: EMBASSY DESCRIBES BELOW CERTAIN POLITICAL AND ECONOMIC REALITIES WHICH SHARPLY LIMIT PERU'S ECONOMIC POLICY ALTERNATIVES AT THIS TIME. THESE PARAMETERS INCLUDE INTER ALIA A HIGH DEGREE OF POPULAR UNREST WHICH COULD BE TRANSLATED INTO RIOTS AND OTHER VIOLENT ACTS IF GOP UNDERTOOK FURTHER AUSTERITY MEASURES UNMITIGATED BY STEPS TO EASE WORKERS' LOT AT LEAST TEMPORARILY. EMBASSY ANALYSIS BASED ON UNQUESTIONED FACT THAT PERU IS OPERATING ON HAND-TO-MOUTH BASIS WITH FOREIGN EXCHANGE, AND WITHOUT OUTSIDE UNDERSTANDING AND ASSISTANCE WILL BE FACED WITH DEFAULT OR FORCED RESCHEDULING OF OUTSTANDING OBLIGATIONS BEFORE AND THE END OF AUGUST. THESE PARAMETERS MAKE PARTICULARLY AGONIZING KEY ECONOMIC POLICIES BEING THRESHED OUT THIS WEEK AT HIGHEST LEVELS WITHIN GOP. SOME INDICATION OF NEW POLICY DIRECTIONS WILL PROBABLY BE GIVEN IN PRESIDENT'S SPEECH ON JULY 28, ALTHOUGH THE DETAILS WILL BE RESERVED FOR A LATER PRONOUNCEMENT BY MINISTER OF ECONOMY AND FINANCE. END SUMMARY.

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2. IT IS CLEAR THAT THE UNEXPECTED FAILURE OF THE JUNTA AND THE COUNCIL OF MINISTERS DURING THE JULY 4-5 PERIOD TO APPROVE THE PIAZZA ECONOMIC PROGRAM INCLUDING IMF NEGOTIATING PACKAGE WAS DUE IN CONSIDERABLE PART TO THE SERIOUS RIOTS IN VARIOUS CITIES IN PERU (LIMA 5892) WHICH FOLLOWED THE IMPLEMENTATION OF THE AUSTERITY PROGRAM INTRODUCED ON JUNE 10. REACTION OF THE PERUVIAN

WORKERS TO THESE MEASURES CULMINATING IN THE JULY 19 STRIKE IS UNDERSTANDABLE IN VIEW OF THE FACT THAT THEIR PURCHASING POWER HAS DECLINED BY AN ESTIMATED 40 PERCENT DURING THE PAST 18 MONTHS. VIGOROUS ACTION BY GOP TO RESTORE ORDER FOLLOWING DISTURBANCES PRECIPITATED FURTHER NEGATIVE RESPONSE, INCLUDING A PASTORAL LETTER DENOUNCING ALLEGED ABUSES OF HUMAN RIGHTS (LIMA 5945), AND EXPRESSIONS OF ANGER AND FRUSTRATION ON THE PART OF COMMUNIST-LED CGTP AND OTHER UNIONS OVER THE DETENTION OF MANY LEFTIST LABOR LEADERS. THE SITUATION CONTINUES TO BE VERY TENSE, AS THE CENTROMIN STRIKE GOES INTO ITS THIRD DAY AT LA OROYA AND OTHER MINING CENTERS, AND EXTREME LEFTIST TEACHERS AND BANK WORKERS UNIONS THREATEN TO WALK OUT IN PROTEST OVER THE LABOR LEADERS ARREST. PUEBLO JOVENES (SLUM TOWNS AROUND LIMA) SUCH AS VILLA SALVADOR, COMAS AND SAN JUAN DE MIRAFLORES ARE POTENTIAL POWDER KEYS AWAITING FURTHER SPARKS OF DISCONTENT. SERIOUSNESS OF SITUATION HAS BEEN STRESSED TO US IN PRIVATE CONVERSATIONS WITH CHURCH LEADERS, GOVERNMENT OFFICIALS, INDEPENDENT JOURNALISTS AND PRIVATE CITIZENS, AND WE ARE CONVINCED THAT THIS PROBLEM MUST BE TAKEN INTO ACCOUNT AS GOP DECIDES ON NEW POLICY MEASURES. EXACERBATING THIS DISSATISFACTION BY PERUVIAN WAGE-EARNERS IS THE WIDESPREAD BELIEF THAT THE MILITARY GOVERNMENT IS BECOMING INCREASINGLY CORRUPT, AND THAT PROFITEERING IN FOODSTUFFS AND OTHER CONSUMER ARTICLES IS BECOMING ENDEMIC.

3. FINANCIAL CRISIS. MEANWHILE, THE FAILURE OF THE GOP TO OBTAIN
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IMF STANDBY AND SUBSEQUENT NEW COMMERCIAL BANK CREDITS IN RECENT WEEKS (LIMA 5936) HAS RESULTED IN A SERIOUS RESERVE CRISIS AT THE BANCO CENTRAL. WE ARE RELIABLY INFORMED THAT NET RESERVES OF THE CENTRAL BANK ON JULY 20 WERE NEGATIVE 1.3 BILLION DOLLARS, AND THAT THE BANK IS USING EVERY POSSIBLE WAY OF MANIPULATING ACCOUNTS SO AS MEET FOREIGN EXCHANGE DEMANDS ON A DAY-TO-DAY BASIS. ONE REPRESENTATIVE OF LEADING U.S. BANK HERE TOLD EMBASSY ECONOMIC COUNSELOR ON JULY 26 THAT WITH \$60 MILLION IN LIABILITIES COMING DUE OVER THE NEXT FOUR WEEKS PERU WOULD VERY SHORTLY EITHER BE FORCED INTO DEFAULT OR, MORE LIKELY, WOULD HAVE TO SCRAMBLE AROUND FOR THE FORCED RESCHEDULING OF OBLIGATIONS COMING DUE IN AUGUST. IN THIS REGARD, BANKER NOTED, THERE IS A TRIGGER CLAUSE IN THE 1976 \$400 MILLION BALANCE OF PAYMENTS LOAN, AND IF PERU DEFAULTS ON ANY SINGLE OBLIGATION, THEN ALL BECOME PAYABLE AT ONCE. HENCE PERU WILL ALMOST CERTAINLY HAVE TO APPROACH STEERING COMMITTEE OF U.S. BANKS VERY SHORTLY TO APPEAL FOR DEBT RESCHEDULING. IN ANY CASE, FINANCIAL CRISIS IS ACUTE, AND MUST BE TAKEN INTO ACCOUNT BY PERUVIAN POLICY-MAKERS, WHO, IF THEY EMBARK ON A "LESS AUSTERE" PROGRAM (LIMA 6223) WILL FIND IT MORE DIFFICULT TO COME TO A RESCHEDULING AGREEMENT WITH FOREIGN BANKERS.

4. STAGFLATION. AS THE NEW PRESIDENT OF THE CENTRAL BANK HAS ADMITTED, PERU FACES A PERIOD OF LITTLE OR NO REAL GROWTH IN ITS GROSS DOMESTIC PRODUCT COMBINED WITH A SERIOUS INFLATIONARY SITUATION (LIMA 6223). AS A RESULT OF INFLATION, AND THE FAILURE OF WAGES TO KEEP PACE, REAL INCOME FOR WORKERS HAS DECLINED PRECIPITIOUSLY, BUT THE STEPS WHICH THE GOP HAS PROPOSED FOR THE SHORT-TERM AMELIORATION OF THW WORKERS' PLIGHT--E.G. WAGE INCREASES NOT TIED TO PRODUCTIVITY, FURTHER SUBSIDIES FOR FOODSTUFFS WHICH INCREASE THE PUBLIC SECTOR DEFICIT -- ARE THEMSELVES INFLATIONARY. HOW PERU'S ECONOMIC TEAM IS GOING TO STABILIZE THE ECONOMY WHILE IMPROVING THE WORKERS' LOT IN THE SHORT RUN IS A VERY DIFFICULT QUESTION, BUT ONE WHICH MUST BE FACED. WITH REGARD TO THE PUBLIC SECTOR
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BUDGET DEFICIT, WE UNDERSTAND THAT EARLIER ESTIMATES OF 35-50 BILLION SOLES FOR CALENDAR YEAR 1977 HAVE NOW BEEN REVISED UPWARD TO PERHAPS 80 BILLION. THIS LACK OF CONTROL OVER PUBLIC SECTOR EXPENDITURES WILL ALSO POSE PROBLEMS FOR PERUVIAN NEGOTIATORS WITH INTERNATIONAL FINANCIAL INSTITUTIONS AND FOREIGN COMMERCIAL BANKS. SHOULD UNCONTROLLED EXPENDITURES EXTEND TO EHT SENSITIVE AREA OF MORE FOREIGN ARMS PURCHASE, BOTH THIS PROBLEM AND REGIONAL POLITICAL TENSIONS WILL OBVIOUSLY BE INTENSIFIED.

5. COMMENT: WE HAVE OUTLINED ABOVE ONLY A FEW OF THE KEY PARAMETERS WHICH LIMIT THE FLEXIBILITY OF GOP POLICYMAKERS. GIVEN THE PRESENT DIFFICULTIES, IT IS NOT SURPRISING THAT WISHFUL THINKING HAS HELPED SOME CABINET-LEVEL PERUVIANS TO HOPE FOR A MASSIVE FINANCIAL BAILOUT FROM SOME MYSTERIOUS "PETRODOLLAR" SOURCE (LIMA 6227). BUT THIS WILL ALMOST CERTAINLY NOT COME TO PASS, AND PERU WILL HAVE TO FIND ITS SALVATION BY TREADING THE NARROW PATH BETWEEN GREATER POPULAR DISCONTENT WITH ANY HARSH NEW AUSTERITY MEASURES ON THE ONE HAND, AND THE DISSATISFACTION OF THE INTERNATIONAL BANKING COMMUNITY WITH TOO DRASTIC A CHANGE FROM PREVIOUS AUSTERITY MEASURES ON THE OTHER. THESE AGAONIZING POLICY CONSTRAINTS WILL ALMOST SURELY BE REFLECTED AT LEAST IN GENERAL TERMS IN PRESIDENT MORALES BERMUDEZ'S JULY 28 SPEECH TO THE NATION. THEY MAY ALSO AFFECT HIS JUDGMENT AS TO WHETHER FURTHER STEPS TOWARD AN EVENTUAL RETURN TO CIVILIAN GOVERNMENT IN PERU CAN BE ANNOUNCED AT THIS TIME. SHLAUDEMAN

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